Lotteworld Engineering & Construction Sdn Bhd v Castle Inn Sdn Bhd & Anor

HIGH COURT (KUALA LUMPUR) — CIVIL SUIT NO D6-22-2540 OF 1998
REKHRAJ J
30 NOVEMBER 1998

Contract *— Building contract — Performance bond — Breach of contract by contractor — Demand of sum under performance bond against guarantor — Contractor applied for injunction on demand until disposal of trial — Whether demand made in conformity with requirement of bond — Whether injunction should be granted*

This was an inter partes application by the plaintiff for an injunction against the first defendant. The plaintiff (the contractor) and the first defendant (the principal) had executed a formal contract for the construction and completion of a project. Prior to the signing of the contract, there was a letter of acceptance in which one of the terms and conditions precedent reserved by the first defendant was for the plaintiff to deposit with the first defendant a performance bond. The performance bond was to secure the performance of the contract and in the event of breach, the second defendant (the guarantor) was to pay the first defendant the sum under the performance bond. The plaintiff accepted the terms by signing the acceptance letter. Upon breach of the contract, the first defendant sent a letter of demand to the second defendant for the sum under the performance bond. Subsequently, the plaintiff obtained an ex parte order from this court restraining the first defendant from further calling or receiving the sum demanded until the hearing and disposal of this application. At the hearing of this application, counsel for the plaintiff submitted that the performance bond was void as at the time the performance bond was obtained, there was no contract and that the demand letter was not a proper and/or valid demand.

Held, dismissing the application and setting aside the ex parte injunction:

(1) The words of the performance bond were clear in the context and consistent with an immediate undertaking to pay on written demand without any protest by the plaintiff. The beneficiary is entitled to forfeit the cash deposit, if such had been obtained or in the case of a bond, an advantage to immediate payment before the underlying dispute is determined either by trial or arbitration. The court will not attribute an intention contrary to the plain meaning of the words used to attach liability towards payment upon demand (see p 112E–G).

(2) The demand letter had carried with it representations that there had been a breach of the underlying contract supported with a long list of defaults by the plaintiff. As the performance bond is equated to irrevocable letters of credit, the court would not disturb the established mercantile practice of treating the rights of

the beneficiary to payment forthwith as equivalent to cash in hand (see p 113F–G). A

[**Bahasa Malaysia summary**

Ini merupakan suatu permohonan inter partes oleh plaintif untuk suatu injunksi terhadap defendan pertama. Plaintif (kontraktor) dan defendan pertama (prinsipal) telah melaksanakan suatu kontrak rasmi untuk pembinaan dan penyempurnaan suatu projek. Sebelum kontrak tersebut ditandatangani, terdapat suatu surat penerimaan dalam mana salah satu daripada syarat dan terma terdahulu yang dikhaskan oleh defendan pertama ialah plaintif hendaklah mendepositkan suatu bon pelaksanaan dengan defendan pertama. Bon pelaksanaan adalah untuk menjamin pelaksanaan kontrak dan sekiranya kemungkiran berlaku, defendan kedua (penjamin) hendaklah membayar defendan pertama jumlah di bawah bon pelaksanaan. Plaintif telah menerima syarat-syarat tersebut dengan menandatangani surat penerimaan. Apabila kemungkiran kontrak tersebut berlaku, defendan pertama telah menghantar surat tuntutan kepada defendan kedua untuk jumlah di bawah bon pelaksanaan. Berikutnya, plaintif memperolehi suatu perintah ex parte daripada mahkamah ini menahan defendan pertama daripada menuntut atau menerima jumlah yang dituntut selanjutnya sehingga pembicaraan dan penyelesaian permohonan ini. Di pembicaraan permohonan ini, peguam plaintif berhujah bahawa bon pelaksanaan adalah terbatal kerana semasa bon pelaksanaan diperolehi, tidak wujudnya kontrak dan bahawa surat tuntutan bukanlah satu tuntutan yang wajar dan/atau sah. B C D E

Diputuskan, menolak permohonan dan mengetepikan injunksi ex parte: F

(1) Penyusunan kata dalam bon pelaksanaan adalah jelas dalam konteks dan konsisten dengan akujanji segera untuk membayar atas tuntutan bertulis tanpa sebarang bantahan oleh plaintif. Benefisiari berhak melucutkan deposit tunai, andainya ia telah diperolehi atau dalam keadaan satu bon, suatu manfaat kepada bayaran segera sebelum pertikaian ditentukan sama ada melalui perbicaraan atau timbangtara. Mahkamah tidak akan mentafsirkan hasrat yang bertentangan dengan maksud jelas perkataan-perkataan yang digunakan bagi mengenakan liabiliti terhadap bayaran atas tuntutan (lihat ms 112E–G). G H

(2) Surat tuntutan telah membawa bersamanya representasi-representasi bahawa terdapat kemungkiran kontrak disokong oleh suatu senarai keingkaran oleh plaintif. Oleh kerana bon pelaksanaan disamakan dengan surat kredit yang tidak boleh ditarik balik, mahkamah tidak akan mengganggu amalan merkantil mantap yang menganggap hak-hak benefisiari kepada bayaran setara dengan tunai dalam tangan (lihat ms 113F–G).] I

Notes

For cases on performance bond in building contract, see 3 *Mallal's Digest* (4th Ed, 1997 Reissue) paras 1775–1778.

Cases referred to

Edward Owen Engineering Ltd v Barclays Bank International Ltd & Anor [1978] QB 159 (refd)

Esal (Commodities) Ltd, Re [1985] BCLC 450 (refd)

Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd [1995] 1 MLJ 149 (refd)

IE Contractors v Llyod's Bank plc & Rafidain Bank [1989] 2 Lloyd's Rep 205; [1990] 2 Lloyd's Rep 296 (refd)

Lee Ah Chor v Southern Bank Bhd [1991] 1 MLJ 428 (refd)

Teknik Cekap Sdn Bhd v Public Bank Bhd [1995] 3 MLJ 449 (refd)

Legislation referred to

Evidence Act 1950 s 94

Vincent Lim (*Kenneth Lye* and *Yap Hsu Lyin* with him) (*Vincent Lim & Teoh*) for the plaintiff.

Bill Davidson (*Lim Chong Fong* and *Annabel Chua* with him) (*Azman Davidson & Co*) for the first defendant.

Cur Adv Vult

Rekhraj J: The plaintiff took out a writ on 24 July 1998 for a declaratory order:

(i) that the performance bond dated 22 August 1998 was supplementary to a contract dated 15 July 1995 and thus invalid;

(ii) that the said contract and/or the performance bond did not permit the first defendant, whether by itself and/or through its agents or servants, to make a call on the performance bond;

(iii) that an injunction be granted against the first defendant whether by itself or through its agents or servants from further calling and/or receiving the payment in the sum of RM4.8m which was payable upon the principal's written demand made on the second named defendant until the disposal of the arbitration;

(iv) for a declaration that the said performance bond is a conditional bond and that the second defendant is only obliged to pay to the first named defendant upon proof that the plaintiff is in breach of the obligations under the said contract and that the *plaintiff* is not relieved from the performance of the contract;

(v) that the second named defendant whether by itself or by its servants or agents be injuncted and restrained from paying the said sum of RM4.8m or any other sum that shall be payable under the performance bond until the disposal of the arbitration proceedings; and

(vi) other order/direction or relief as this honourable court may think just and proper. A

Simultaneously with the writ, the plaintiff took out an ex parte summons in chambers for an order:

(a) that an injunction be granted against the first named defendant whether by itself, or by its servants or agents from further calling and or receiving payment in the sum of RM4.8m under the performance bond from the second named defendant, until the disposal of this matter inter partes; and B

(b) an injunction against the second named defendant, restraining them from paying the first defendant, the sum of RM4.8m or any sum payable under the performance bond until the disposal of the hearing inter partes. C

The said summons in chambers was supported by an affidavit dated 24 July 1998 of Joe Hyon Joe, a director of the plaintiff company wherein in para 3 he had deposed that the plaintiff and the first defendant had executed a formal contract (indentified as contract dated 15 July 1995) for the construction and completion of a project for the sum of RM96m. D

Prior to the signing of the said formal contract, there was on record a letter dated 30 June 1995 — letter of acceptance under which the plaintiff was required: E

(i) to execute in due course a formal contract (contract dated 15 July 1995, executed on 9 January 1996); and

(ii) until the execution of the said formal contract — the letter of acceptance shall constitute a binding contract between the plaintiff and the first named defendant. F

One of the terms and conditions precedent reserved by the first named defendant under the letter of acceptance was for the plaintiff to deposit with the first named defendant a performance bond (being 5% of the contracted sum of RM96m) in the form of an approved banker's guarantee or in cash and that this letter of acceptance shall take precedence over any other document in the event of disputes as to the construction of the contract. The plaintiff duly accepted the terms laid by signing the acceptance letter and in pursuance thereto did produce — for the benefit of the first defendant instead of cash deposit, a performance bond — vide Bank Guarantee No 0686/95/01925 which reads: G H

Scotiabank
The Bank of Nova Scotia Bhd

This guarantee must be returned to the bank for cancellation on expiry.

(Bank Guarantee No 0686/95/01925)

This agreement is made 22 August 1995, between The Bank of Nova Scotia Bhd of Menara Boustead, No 69, Jalan Raja Chulan, 50200 Kuala Lumpur ('the guarantor') of the one part and Castle Inn Sdn Bhd of Suite 138, First I

A Floor, Johor Tower, Jalan Gereja, 80100 Johor Bahru, Johor ('the principal') of the other part.

Whereas

(1) This agreement is supplementary to a Contract No ... ('the contract') dated 15 July 1995 and made between Lotteworld Engineering and Construction Sdn Bhd of Suite 11.2B, Level 11, Menara Pelangi, No 2, Jalan Kuning, Taman Pelangi, 80400 Johor Bahru, Johor ('the contractor') of the one part and the principal of the other part whereby the contractor agreed and undertake the execution and completion of the proposed hotel cum office development at Jalan Harimau, Johor Bahru, Johor for Castle Inn Sdn Bhd for the sum of Ringgit Malaysia ninety six million only (RM96m).

(2) The guarantor has agreed to guarantee the due performance of the said contract in the manner hereinafter appearing.

Now the guarantor hereby agrees with the principal as follows:

(1) If the contractor (unless relieved from the performance by any clause of the contract or by statute or by the decision of a tribunal of competent jurisdiction) shall in any respect fail to execute the contract or commit any breach of his obligations thereunder then the guarantor shall pay to the principal up to and not exceeding the sum of Ringgit Malaysia four million eight hundred thousand only (RM4.8m) representing 5% of the contract value or such part thereof, on the principal's written demand notwithstanding any contestation or protest by the contractor or by guarantor or by any other third party. Provided always that the total of all partial written demands so made shall not exceed the sum of Ringgit Malaysia four million eight hundred thousand only (RM4.8m) and that the guarantor's liability to pay the principal as aforesaid shall correspondingly be reduced proportionate to any partial demand having been made and paid as aforesaid.

(2) The guarantor shall not be discharged or released from this guarantee by any arrangement between the contractor and the principal with or without the consent of the guarantor or by any alteration in the obligations undertaken by the contractor or by any forbearance whether as to payment, time, performance or otherwise, but the guarantor shall be entitled to be informed of such arrangement or alteration.

(3) This guarantee shall be irrevocable and shall remain in force and effect until the expiry of the defects liability period for the whole of the works plus six months, ie 14 January 1999 or any authorized extension thereof, and in the case of the contract being determined, one calendar year after the date of the determination. Claims, if any, must be received by the guarantor within the period of the guarantee ie on or before 14 January 1999.

Given under our hand the date first above mentioned.

Signed for and on	)	.....
behalf of	) Name: Evelyn Quek	Daniel Chao
The Bank of Nova	) Designation: Q12	Manager
Scotia Bhd	) Asst Manager Administration	
in the presence of	) Customer Service/	
	) Trade Finance	

A

.....
Witness : Lee Tean Poh
L763

Name : .....
Designation: Accounting Officer

B

Signed for and on) .....
behalf of the principal) Name:
in the presence of) Designation:

.....
Witness:

C

Name: .....
Designation: .....

The plaintiff through its director in para 6 of the supporting affidavit admitted that 'In the course of the works, disputes arose which include, inter alia:

D

(a) wrongful deduction of liquidated damages arising from the disputed certificate of non-completion, time being at large;

(b) improper certification of work done and loss and expense;

(c) inadequacy of the extension of time awarded;

E

(d) variation of claims;

(e) issuance of the notice of default dated 26 June 1998 purportedly under cl 25 of the conditions of contract.

At the ex parte hearing on 24 July 1998, on a certificate of urgency, I granted to the plaintiff only the first part of prayer (a) under the summons in that 'restraining the first named defendant from further calling and/or receiving the sum of RM4.8m from the second named defendant until the hearing and disposal of the inter partes application.'

F

The present inter partes application is taken out by the plaintiff for an injunction — inter alia, that the first named defendant, whether by itself or by its agents or servants be restrained from further calling on and/or receiving payment in the sum of RM4.8m ..., until the disposal of the suit filed herein and or alternatively, of the arbitration.

G

For the purposes of this hearing it is an admitted fact:

(i) that a written demand has been made by the first named defendant's solicitors upon the second named defendant on 18 July 1998, demanding the sum of RM4.8m payable under the performance bond and in the demand, have complained of the various breaches committed by the plaintiff as stated in an annexure to the notice issued by the architect's letter dated 26 June 1998;

H

(ii) that there is a dispute between the parties; and

I

(iii) that as a result of the dispute, the plaintiff has now demanded arbitration proceedings by giving notice to the first named defendant to

A arbitrate under cl 34(1) which reads 'In the event that any dispute or difference should arise between the employer (first defendant) or the architect on his behalf and the contractor (the plaintiff), either through the progress or after the completion or abandonment of the works, ... then such dispute(s) or difference shall be referred to arbitration.'

B What the plaintiff's counsel basically submits in his written submission is:

(i) that there is a dispute underlying the contract because when the performance bond was obtained on 22 August 1995 in compliance to the letter of acceptance dated 30 June 1995, there was then no such contract and as such the performance bond is void ab initio and that
C this court do exercise its equitable jurisdiction in restraining the defendant from calling on the bond until the resolution of their dispute by trial or by arbitration;

(ii) that the demand letter made by the first named defendant's solicitors on the second defendant was not a proper and/or valid demand; and

D (iii) that the call by the first defendant on the second defendant, under the said bond was fraudulent, inequitable and/or unconscionable.

The first named defendant in their submission submitted:

(i) that the performance bond was in fact payable upon a pure written demand, notwithstanding any contestation or protest by the contractor
E but nonetheless they have, at the time of making the demand, complained of the breaches as shown in the exhibit to a letter dated 26 June 1998, of those defects and or defaults to bring themselves within *Teknik Cekap Sdn Bhd v Public Bank Bhd* [1995] 3 MLJ 449;

(ii) that a valid and proper demand has been made by the first named
F defendant's solicitors as the agents of the first named defendant (*Lee Ah Chor v Southern Bank Bhd* [1991] 1 MLJ 428 at p 432); and

(iii) that in the light thereof there are no justifiable grounds for the ex parte injunction to be extended or continue upon inter partes hearing.

G It is to be understood that the purpose of the performance bond in the construction industry is to perform the role of an effective safeguards against non-performance, inadequate performance or delayed performance and its production provides a security as readily available to be realized, when the prescribed event occurs, viz a viz simply failing to complete the work which had been contracted to carry out. Therefore, the letter of
H acceptance dated 30 June 1995 requiring the performance bond for RM4.8m or cash deposit in lieu thereof and the performance bond dated 22 August 1995, must be read together as co-temporaneous document underlying the only meaning:

> I that an unconditional undertaking is given on the part of the second defendant to pay the specified sum to the first named defendant, on a pure and simple demand, stating that the plaintiff is in default, and that once a demand of that nature has been made, the various equitable defences which are prayed for, are no longer available to the issuer and or to the requester of the bond.

This argument has been well fortified in the leading case of *Edward Owen Engineering Ltd v Barclays Bank International Ltd & Anor* [1978] QB 159, where the performance bond was payable 'on first of our demand without any condition or proof.' The Court of Appeal in the case of *Re Esal (Commodities) Ltd* [1985] BCLC 450 in its literal interpretation of the words 'We undertake to pay the said amount on your written demand in the event the supplier fails to execute the contract in perfect performance', rejected the argument of strict application in accordance with its terms as that would have meant that the beneficiary would have to prove a failure to perform the contract, rather than simply to assert it.

The choice words of the performance bond are:

> If the contractor (unless relieved from the performance by any clause of the contract or by statute or by the decision of tribunal of competent jurisdiction) shall in any respect fail to execute the contract or commit any breach of his obligation thereunder then the guarantor shall pay ... on the principal's written demand notwithstanding any contestation or protest by the contractor or by the guarantor or by any other third party ... .

The performance bond was procured by the plaintiff to the first named defendant and the plaintiff was fully aware of the choice of words expressing the intention — that it was payable, notwithstanding any contestation or protest by the contractor. It would be superfluous to submit now that it was not so intended and that the payment was subject to a dispute being decided because s 94 of the Evidence Act 1950, which reads — 'when language used in a document is plain (ie unambiguous) in itself and when it applies accurately to existing facts, evidence may not be given to show that it was not meant to apply to such facts'. The words of the performance bond are clear in the context and consistent with an immediate undertaking to pay on written demand without any protest by the plaintiff, in that, the beneficiary is entitled to forfeit the cash deposit — if such had been obtained or in the case of a bond, an advantage to immediate payment before the underlying dispute is determined either by trial or by arbitration'. This court will not therefore attribute an intention contrary to the plain meaning of the words used to attach liability towards payment upon demand.

The next question is whether or not the beneficiary has made a demand in conformity with the requirement of the bond and for that, the court has to adopt the two fold approach as laid by Leggatt J in the case of *IE Contractors v Llyod's Bank plc and Rafidain Bank* [1989] 2 Lloyd's Rep 205; [1990] 2 Lloyd's Rep 296 and affirmed by the Court of Appeal:

(i) It must construe the bond to see what the beneficiary has to do for the purpose of making a valid demand under it.

(ii) It must construe the call ... to see whether the beneficiary has complied with that obligation.

Now looking at the demand letter dated 18 July 1998, addressed to the second named defendant:

A Azman, Davidson & Co

LCF/AC/tyh/195/97P 18 July 1998

The Bank of Nova Scotia Bhd By Hand
Menara Boustead
No 69, Jalan Raja Chulan
B PO Box 11056
50734 Kuala Lumpur

Dear Sirs,

C *Contract dated 15 July 1995 between Castle Inn Sdn Bhd and Lotteworld llEngineering & Construction Sdn Bhd for the execution and completion of the proposed hotel cum office development at Jalan Harimau, Johor Bahru, Johor ('the contract')*

Bank Guarantee No 0686/95/01925 for the amount of RM4.8m ('the performance bond')

D We act for Messrs Castle Inn Sdn Bhd who is the beneficiary in respect of the above matter.

We are instructed to inform you that Lotteworld Engineering & Construction Sdn Bhd is in breach of its obligations under the contract, inter alia, for failing to comply with the architect's notice of default dated 26 June 1998 resulting in our client determining Lotteworld Engineering & Construction Sdn Bhd's employment under the contract. Please find enclosed
E the relevant letters.

We hereby demand that the sum of RM4.8m under the performance bond be paid forthwith to our client or to us as its solicitors.

Yours faithfully,
F Azman, Davidson & Co
(Sgd)
Lim Chong Fong

cc : client

G The demand letter as exhibited has carried with it the representations that there has been a breach of the underlying contract supported by Appendix A — showing a long list of defaults by the plaintiff. As the performance bonds are equated to irrevocable letters of credit — being 'the life blood of international commerce', this court will not, short of fraud supported by corroborative evidence, disturb the established mercantile practice of treating the rights of the beneficiary to payment forthwith as
H equivalent to cash in hand. The case of *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd* [1995] 1 MLJ 149 has once and for all decided that once a demand has been made by the beneficiary before the injunctive relief was sought, the beneficiary could not be enjoined as a party to the proceedings, and/or injuncted from further calling or receiving the sum under the performance bond as to allow otherwise would undermine the certainty and
I effectiveness of the performance bond of its commercial value. In that case, Kago were the sellers of certain goods to Esso with time of delivery being of the essence. It was agreed between them that Esso was entitled to deduct a

maximum of 10% of the purchase price in respect of any delays in delivery but Esso paid the full price in advance in return for two performance bonds issued by Kago's bank for a sum which was equivalent to the 10% potential deduction. Esso subsequently claimed damages for the delay. Kago sought particulars of the calculation, but Esso, without replying to the request, made a written demand to the bank under its performance bond for the said sum. Kago obtained an ex parte injunction restraining Esso from receiving the money under the performance bond alleging, inter alia, that the delays were as a result of Esso's own fault. The High Court refused to set aside the injunction granted ex parte, but the Supreme Court on appeal held that there was no reason to impeach the demand and therefore there was no basis for an injunction being granted against the paying bank. However, as the injunction had not been sought against the bank, but only against the beneficiary from calling and/or receiving (as in this case), the Supreme Court went on to consider the question whether an indirect injunction could be granted against Esso in the circumstances. It held that although there was jurisdiction to grant an injunction against Esso, the balance of convenience was clearly in favour of the beneficiary — Esso and re-enforced that the performance bond occupied an important place in the national and international world of commerce, and as such, would not lightly be interfered with. This case has in fact founded a maxim: 'The courts will refuse to lend its aid to subvert indirectly the performance bond after a demand has been made by means of a direct injunction against the beneficiary on grounds of a simple allegation of breach of contract'.

I therefore set aside the ex parte injunction that had been granted to the plaintiff from restraining the first named defendant from further calling and/or receiving the sum under the performance bond and dismiss this inter partes application with all costs and I further order, in lieu of damages under the applicants undertaking as to damages, interest at the rate of 8%pa on the sum of RM4.8m payable by the plaintiff to the first named defendant from the 18 July 1998, being the date of the demand, because the beneficiary has in fact been unjustifiably deprived of the use of his money from that date, by an uncalled for injunction.

Application dismissed. Ex parte injunction set aside.

Reported by Mohd Rizal Abidin